

Study of Desirability and Convenience for Luis Muñoz Marín International Airport

JUNE 2010

General disclosure

This Desirability and Convenience Study (the "Study") has been prepared pursuant to the requirements of the Public-Private Partnerships Act (the "Act"). This Study seeks to determine whether the establishment of the proposed Public Private Partnership ("PPP") is advisable.

This Study was formulated according to the Desirability and Convenience Study General Guidelines which are acceptable to the Public-Private Partnerships Authority (the "Authority"). This Study was prepared by the Authority and the Puerto Rico Ports Authority, the Partnering Government Entity in the proposed PPP with the assistance of its financial advisor Credit Suisse Securities (USA) LLC (the "Advisor") as part of a financial, procurement and technical advisory engagement between the Advisor and the Authority.

This Study is based on estimates, assumptions and market information obtained from sources believed to be reliable. Actual results may vary from those anticipated in this Study. Changes in the aviation industry may occur which can alter the assumptions and conclusions presented in this Study. Neither the Authority nor the Advisor makes any representation or warranty whatsoever, including representations and warranties as to the accuracy or completeness of the information contained in this Study, including estimates, forecasts or extrapolations. In addition, the Study includes certain projections and forward-looking statements provided by the Authority with respect to the anticipated future performance. Such projections and forward-looking statements reflect various assumptions, and are subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond the control of the Authority. Accordingly, there can be no assurance that such projections and forward-looking statements will be realized. The actual results may vary from the anticipated results and such variations may be material. No representations or warranties are made as to the accuracy or reasonableness of such assumptions or the projections or forward-looking statements based thereon. The Authority and the Advisor expressly disclaim any liability for any representations or warranties, expressed or implied, contained herein or for any omissions from this Study or for any other matter related to this Study. The Advisor has not independently verified any of the information contained herein.

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Each person should make an independent assessment of the merits of pursuing a transaction involving the Company and should consult such person's own professional advisors.

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1. Executive summary

1.1. Introduction

The Puerto Rico Ports Authority (“PRPA”) is responsible for providing safe and reliable air travel to the travelling public at Luis Muñoz Marín International Airport (“LMM” or the “Airport”). The Airport represents an important infrastructure asset for Puerto Rico’s tourism and economic development. However, historical management deficiencies have not allowed LMM to reach its full potential. Also, the financial profile of both the Airport and the PRPA and broader economic weakness impacting air travel generally have impacted the Airport’s ability to render the necessary services in an efficient, cost-effective and satisfactory manner. In order to improve the services provided at the Airport for all key constituents, the PRPA has determined that it must make upgrades to its infrastructure and improve the overall management of the Airport.

PRPA is interested in implementing a Public-Private Partnership (“PPP”) with one or more concessionaires to reduce the PRPA’s risk and implement certain initiatives, as permitted by Act No. 29 approved on June 8, 2009 (the “Act”), which include, but are not limited to, substantial upgrades to the infrastructure at the airport, identifying new revenue opportunities at the Airport and improving the overall financial management of the Airport. The benefits to the travelling public from the implementation of these initiatives will improve the overall service provided by the Airport. There are also significant benefits to the Puerto Rican economy from additional passenger traffic through the Airport, including tax revenues, an increase in gross product and job creation.

PRPA’s proposed project (the “Project”) has been selected by the PPP Authority (the “P3 Authority”) as a potential project for a PPP and has been included in the P3 Authority’s inventory of projects. This document serves as the Study of Desirability and Convenience for the Project required by the Act.

1.2. Background and service delivery plan

The PRPA has recently invested resources in examining its service delivery of LMM. The analysis includes the credit profile of the PRPA, as published by the credit agencies and benchmarking of LMM versus peers on key airport metrics, including aeronautical and non-aeronautical revenues. A summary of this analysis is:

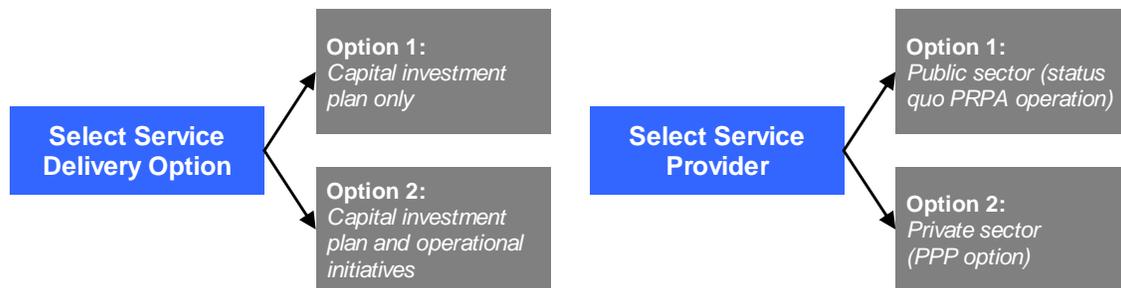
- LMM’s performance has lagged key Caribbean peers in total passenger growth. Dominican Republic airports and Miami International Airport saw increases in traffic in 2008, while the traffic at LMM declined. Additionally, LMM has lost European inbound market share to the Dominican Republic since 2005.
- The financial performance of the PRPA, and particularly the aviation operations (of which LMM is the largest component), has been flat over the past three years and has resulted in increasing costs.
- As a result of the financial performance and the PRPA’s capital structure, the credit profile of the PRPA has come under scrutiny by both Moody’s and S&P. On May 13, 2010, Moody’s affirmed its negative outlook on the PRPA and cited its support from the GDB as a key factor in not being rated lower. This is important given that LMM projects are financed using the credit ratings of the PRPA.
- Enplanements have decreased over the past three years and the Airport has been unable to recover the lost enplanements related to the American / American Eagle announcement in 2008 to reduce capacity at LMM.
- While the Airport has strong aero-revenues, it underperforms significantly, relative to its peers, in food & beverage revenues, car rental revenues and car parking revenues on a per-passenger yield basis.

The Airport, under the operation of the PRPA, fails to adequately serve the needs of travellers at LMM. The PRPA has identified opportunities, including better financial management practices, improving Airport amenities and services

and raising the profile of LMM as an international hub to South America. Capital investments in infrastructure and several operational initiatives in represent the potential scope of work for this Project.

1.3. Service delivery options

Two PPP service delivery options and two service delivery providers were evaluated at LMM to better serve the needs of the travellers at the Airport. Service delivery Option 1 is to make capital investments in the Airport’s infrastructure and facilities. Option 2 is to make the same investments and implement a new financial management strategy with operational initiatives. The two service provider options are the public sector (maintaining PRPA ownership and operatorship) and the private sector (using a PPP to operate the Airport and implement the investments and initiatives). A summary of the options is below:



The combination of both Option 2s is the preferred alternative because it fully addresses the issues at LMM as a whole, addresses environmental and socioeconomic issues and allocates the most risk to the private sector, which is best able to absorb it. Operational initiatives, alongside the infrastructure investments, fully address the issues at the Airport today, including sub-optimal facilities and cost overruns. Further, the private sector is able to leverage world-class airport operating expertise that the public sector does not have.

In order to properly address the service needs of the Airport users, the PRPA has determined that a private partner or concessionaire should implement:

- A disciplined capital investment plan that upgrades the Airport’s infrastructure and improves its attractiveness to travellers, air carriers and cargo carriers;
- A revenue generation plan that analyzes revenue opportunities, particularly related to commercial or non-aeronautical activities, including food and beverage outlets, car parking and car rentals; and,
- Improved financial efficiency related to general and administrative and overhead expenses at the Airport that have reduced profitability over the past three years and limited PRPA’s ability to continue funding the necessary capital improvement program.

PRPA believes that the best contracting option for the Project is a PPP or long-term lease that typically includes three or four principal agreements involving the airlines, the concessionaire, the Airport operator and the PRPA. It is expected that these agreements would include a new Airport Use Agreement, an Operating Standards Agreement and a Concession and Lease Agreement. The long-term lease would include an upfront payment to the PRPA.

Airport PPPs are common practice around the world, with over 40 having occurred in Europe, Asia, the Pacific and South and Latin America. In each of the concessions, world-class airport operators have significantly improved the service offerings for airport users. A selection of recent concessions is listed below:

- Gatwick (London, U.K)
- Cairns Airport (Queensland, Australia)
- Mackay Airport (Queensland, Australia)
- Schiphol Airport (Amsterdam, Netherlands)
- Brussels Airport (Brussels, Belgium)
- London City Airport (London, U.K.)
- Copenhagen Airport (Copenhagen, Denmark)
- Mexico Grupo Aeroportuario del Pacífico (Mexico)
- Airports of Thailand (Thailand)
- Belfast City Airport (Belfast, Northern Ireland)

While airport PPPs are common practice around the world, there has not been a completed airport PPP in the United States, under the FAA Pilot Program. Puerto Rico’s PPP of LMM would be the first of its kind at an FAA regulated airport and would set the precedent for future airports to follow in the U.S.

1.4. Economic feasibility analysis

PRPA envisions receiving upfront net proceeds associated with the long-term lease of the Airport. The value of the Airport will be based on a bidder’s own financial model and opportunities that it believes exist to improve the traffic and financial performance at the Airport. It will also be dependent on the pro forma Airport Use Agreement and the subsequent airline charges generated at the Airport.

Implementing the Project will improve the PRPA’s financial capacity, reduce indebtedness and improve the financial profile of LMM on a standalone basis. It also leverages a world-class airport operator’s financial management expertise at the Airport.

Taking into account the project costs, the PRPA is able to realize upfront net proceeds today from a PPP transaction within the scope and framework of the FAA Pilot Program versus the financial impact of implementing the project on its own of greater than (\$100) million. The value for money is clear:

- Net proceeds in present value terms under a PPP or net costs in present value terms under the status quo.

Finally, increasing passenger traffic at the Airport will ultimately benefit the broader Puerto Rican economy. According to an independent economic report prepared by Advantage Business Consulting, each tourist (which includes cruise ship passengers) to the Island in 2009 had an average impact on the Island’s gross product of \$690 per passenger, including direct and indirect benefits. The report projects 5.6 million total visitors per by year by 2015. Increasing the total number of visitors by 400,000 would have a significant impact on the local economy:

- Increase Puerto Rico’s gross product by \$276 million
- Increase tax collections by \$34 million
- Create 3,772 new jobs

While the increase in visitors to the Island may come from a number of sources, LMM represents the major entry point for most tourists and provides the greatest opportunity to drive additional visitors.

1.5. Affordability analysis

The PRPA has determined that for the Project to be affordable it must not cost more than it would cost the PRPA to implement the capital improvement plan and the operational initiatives. In other words:

- The present value of the PRPA financial impact to continue to operate the Airport must not exceed the estimated upfront net proceeds to the PRPA from a long-term lease of the Airport.

The request for proposals (RFP) will indicate that PRPA only expects to move forward with the Project if the criteria described above are met.

1.6. Conclusion

Currently, Luis Muñoz Marín International Airport does not adequately serve the needs of Puerto Rico's air travelers, nor does it provide a substantial financial benefit to the PRPA. Additionally, the current issues at the PRPA, including its financial performance, credit profile and reliance on GDB credit lines, limit LMM's ability to improve its operations. As such, PRPA has concluded that it needs to change the way LMM is operated. To do this, PRPA must leverage private sector expertise through a PPP to improve the service delivery of the Airport. Through a benchmarking and service delivery analysis, the PRPA has determined that significant opportunities exist to improve the overall experience at the Airport. PRPA has elected to implement a PPP and integrate private sector expertise through a long-term lease of the Airport to a consortium that includes a concessionaire and an airport operator. A Concession and Lease Agreement between the concessionaire and the PRPA would shift almost all of the risk to the private sector. The Project provides an integrated solution for LMM and should attract significant investment.

A successful PPP of LMM will deliver the following results:

- World-class concessionaire delivering best practices to the operation of the Airport, resulting in a more user friendly experience for Puerto Rico's residents and visitors alike that will in turn generate more customer satisfaction. This will include the use of modern technology and more efficient management practices
- Increased Airport traffic via a broader spectrum of airlines, offering greater travelling choices for the local population and increased flow of tourists into Puerto Rico
- Incremental employment opportunities for the people of Puerto Rico, driven by capital / construction projects, expanded retail, food and beverage vendors and increased aircraft traffic
- No degradation of environmental or noise impact on surrounding communities
- A substantial upfront payment by a lessee that will more than offset repayment of LMM debt
- Decreased financial and operational risk for the PRPA and the Government of Puerto Rico
- Prestige of being the first airport to carry out a concession under the FAA Pilot Program
- At the end of the lease, a world-class airport facility will be either returned to Puerto Rico or re-lease for another upfront payment

The concession of Luis Muñoz Marín International Airport will transform it into a world-class airport and a gateway to Puerto Rico – one that the people of Puerto Rico will be proud of. The Airport will contribute to Puerto Rico's economic development.

2. Introduction

2.1. Introduction

The Government of Puerto Rico and its public corporations are responsible for efficiently providing essential services at the lowest possible cost for the welfare of Puerto Rico. These services include, for example: public health and safety, education, and transportation services, among others. Due to fiscal budget deficits at the Government and public corporations levels and limited private investment in infrastructure, the Government has had to adopt non-traditional tools to help deliver these services to the people. On June 8, 2009, the Legislature of Puerto Rico approved Act No. 29 to promote and allow the establishment of Public-Private Partnerships in Puerto Rico for the purposes therein set forth. The P3 Authority was created as a public corporation for the purpose of implementing the public policy of the Government concerning PPP as contemplated under the Act.

The Act requires the Authority to conduct or commission a Study of Desirability and Convenience for each project selected by the Authority as a potential project for a PPP. The Study seeks to assure that a particular project meets the public policy and goals established by the Act and to determine whether the establishment of a PPP in connection with such a project is advisable. The scope of each Study is determined by the Authority, on the basis of the particular facts and circumstances of each project being considered by the Authority for a PPP. Each Study will include, as deemed applicable by the Authority, the matters listed in Article 7(b) of the Act. The Authority may expand or reduce the scope of the Study as it relates to any proposed PPP to include other matters not specifically listed in Article 7(b) of the Act, or exclude matters that are not relevant to a particular project, as appropriate.

Luis Muñoz Marín International Airport is the main commercial airport in Puerto Rico with the largest number of passengers and cargo activity in the Caribbean serving more than 4.2 million enplaned passengers and 222,931 short tons of cargo in FY2009. LMM is currently owned and operated by the Puerto Rico Ports Authority and managed by an Executive Director and a Board of Directors. Due to reductions in passenger traffic and cargo activity as a result of weakening economic activity as well as poor management practices, LMM has experienced deterioration in its financial performance over the past several years. In order to remain operationally competitive and to remove financial burdens from the PRPA, LMM has evaluated its alternatives to improve its financial situation and service to its customers.

The PRPA and the P3 Authority are interested in evaluating the viability of a long-term concession of the Luis Muñoz Marín International Airport to a Concessionaire and airport operator for the capital improvement, operation, maintenance, facilities and commercial development of the Airport (including parking and cargo facilities).

2.2. Project description and objectives

The Project results from PRPA's need to dramatically change the way it operates LMM in order to address operational, financial and managerial deficiencies, as well as reduce significant risk exposure. The PRPA has identified the need for significant capital investment and initiatives to increase financial efficiency at the Airport to improve the user experience. In order to improve the operations at LMM, Puerto Rico will need to make significant investments. However, the PRPA has also acknowledged it does not have the financial capacity and thus cannot afford the investment on its own, and as such, needs to develop a PPP to implement the Project. Implementing the Project as a PPP helps PRPA minimize capital investment costs and risk exposure, as well as providing significant upfront proceeds.

The Project objectives are to:

- Promote capital investment in the Airport by the private sector to continually improve the infrastructure, and ultimately, services offered at LMM
- Optimize value to the PRPA of a long-term lease of the Airport to a concessionaire

- Protect the public interest, including all constituents at the Airport (i.e., employees, management, etc.)
- Improve the financial profile of LMM through better financial management
- Maintain and improve the quality of service to travellers and achieve a higher level of customer satisfaction
- Satisfy FAA and other regulatory requirements
- Create a world-class gateway to Puerto Rico and increase the Island's profile as the destination in the Caribbean. This will have a direct positive impact in the development of the tourism industry in Puerto Rico.

In order to accomplish these objectives, the PRPA must change the way it operates by increasing capital investment, revenue generation and cost controls at the Airport. It must do so while minimizing risk to the public sector, thereby protecting public sector interests. The benefits of implementing a PPP at LMM include:

- World-class airport operation with modern technology and efficient management practices
- Upfront proceeds to the PRPA from the execution of a long-term lease, which can be used to defease high cost debt tied to the Airport and potentially used toward other infrastructure projects
- Significant, disciplined capital investment program financed with lower cost capital tied to a highly rated third party concessionaire
- Upgrade in services offered at the Airport and customer experience
- Significant employment, economic and social benefits to Puerto Rico

The Project objectives and expected benefits are further explained in later sections of this Study.

3. Background and service delivery plan

3.1. General overview of PRPA

The Puerto Rico Ports Authority (“PRPA”) is a public corporation and government body created by Law No. 125 on May 7, 1942. It was created originally as the Transportation Authority of Puerto Rico, under the direction of a General Administrator who reported to a Board of Directors. In 1950, the function of the Board of Directors was transferred to the Administrator of Economic Promotion. The Transportation Authority was renamed the Ports Authority in 1955.

Today, the Ports Authority is directed by an interim Executive Director and a Board of Directors, positions created by Law No. 65 on August 17, 1989. The Secretary of Transportation and Public Works chairs the Board that also includes the Secretary of the Department of Economic Development and Commerce, the Executive Director of the Puerto Rico Industrial Development Company, the Executive Director of the Tourism Company and a representative of the public interest.

The Ports Authority began its activities with the operation of the Metropolitan buses in San Juan. In 1946, the Division of Ports and Wharfs was transferred to the Ports Authority control. In this form, the PRPA became the operator of harbor facilities for foreign trade activities.

In 1947, the Division of Airports was created. The PRPA became the operator of several regional airports by renting the facilities from the U.S. Navy. In 1950, the PRPA became affiliated with the U.S. Department of the Interior and later, the U.S. Department of Transportation and Public Works.

The control of the marine operations gradually expanded by means of acquisition and development of new facilities. Today, the PRPA owns and operates the harbor facilities in San Juan, the harbor area of Isla Grande and the wharfs of Puerto Nuevo. It also administers the wharfs in the harbor zones of Arecibo, Fajardo, Vieques, Culebra, Guayama, Guayanilla and Yabucoa.

The PRPA also continued expanding its airport operations, and in 1955 inaugurated the International Airport of Puerto Rico. The Airport was renamed Luis Muñoz Marín International Airport in 1985. The internationalization of the Airport allowed substantially greater movement of passengers and cargo within the Western Hemisphere to and from the Island. The PRPA also operates the airports of Isla Grande, Ponce, Mayaguez, Arecibo, Aguadilla, Culebra, Humacao, Patillas, Vieques and Fajardo.

During the almost 60 years of history, the PRPA has contributed to significant amounts of commercial, industrial and tourism development within Puerto Rico. These sectors of the economy depend on the infrastructure and services of the PRPA for the transportation of products, tourists and the promotion of international trade. 90% of the commercial movement of the Island are carried out through the facilities of the PRPA.

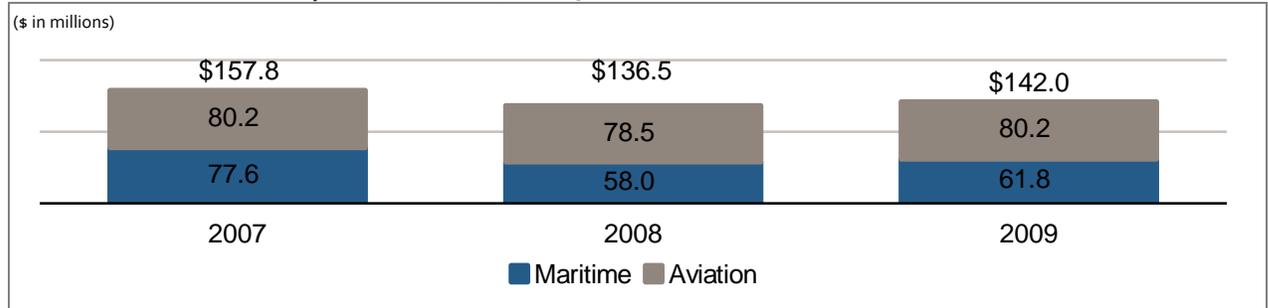
3.2. Service delivery plan of the PRPA

The PRPA’s current financial position has come under considerable pressure, particularly given the broader economic turmoil’s impact on marine and airport operations. The PRPA is also highly susceptible to political and managerial risk, with leadership changing every 4 years, coinciding with government elections. As a result, the PRPA has limited resources, expertise, management continuity and control over the operations at LMM, its largest, and most important, asset.

3.2.1. Financial performance

The PRPA has struggled to grow revenues over the past 3 years. While aviation revenues have remained flat, overall revenues are down 10%, excluding bad debts. While a large part of this can be attributed to the September 2008 announcement by AMR Corp. (parent company of American Airlines and American-Eagle) to reduce capacity by 45% at the airport, the PRPA has been unable to generate additional traffic from other airlines.

Puerto Rico Ports Authority Revenues (2007 – 2009)



Source: Puerto Rico Public-Private Partnerships Authority; Excludes discounts, bad debts and other fees

Further, costs at the PRPA have continued to increase or have been maintained at an elevated level. Operating expenses reached \$186.4 million in fiscal year 2009. This is 8.1% up from fiscal year 2008 and 38.0% from fiscal year 2007. Operating expenses have been more than operating revenues over the past 2 years.

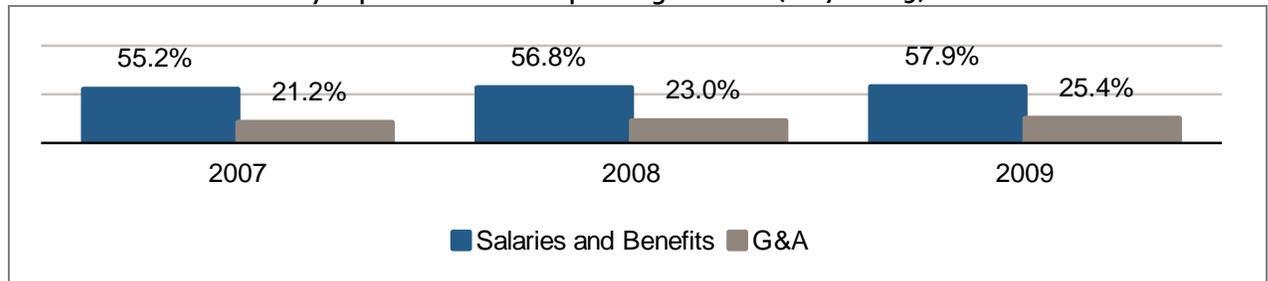
Puerto Rico Ports Authority Operating Expenses (2007 – 2009)



Source: Puerto Rico Public-Private Partnerships Authority

Costs at the PRPA have increased substantially as a percentage of revenue over the same period. Despite difficult operating environments, the PRPA has been unable to find leverage in the cost structure to maintain profitability. Overall, Salaries and Benefits and G&A costs have increased 2.7 percentage points and 4.1 percentage points, respectively, since 2007.

Puerto Rico Ports Authority Expenses as a % of Operating Revenue (2007 – 2009)



Source: Puerto Rico Public-Private Partnerships Authority

3.2.2. PRPA's credit profile

Decreased revenues and expanding costs have led to an impact on how credit agencies view the PRPA, which directly impacts LMM's ability to raise capital to fund infrastructure projects and the daily operations of the Airport. The Airport is not a standalone rated entity by the credit agencies and does not raise debt on its own, therefore relying on the credit profile of the PRPA. Continuing the finance projects and operations at the PRPA's current credit rating will exacerbate the issues at the PRPA.

The PRPA is rated BBB– (Stable) by Standard and Poor's and Baa3 (Negative) by Moody's. According to S&P, the current credit ratings of the Ports Authority are the result of the "moderate likelihood of extraordinary government support" needed to play an important role in providing transit infrastructure to the people of Puerto Rico and visitors. The rating is aided by the strong support from the Government Development Bank for Puerto Rico ("GDB") and the GDB's stated intentions to support the Ports Authority as needed. S&P anticipates that the Ports Authority will continue to manage financial operations to maintain strong senior debt service, but cautions that a downward revision of Puerto Rico and / or GDB ratings, could pressure the Ports Authority's ratings.

On May 13, 2010, Moody's affirmed the PRPA's rating and negative outlook (the outlook was previously revised downward from "Stable" to "Negative" in November 2009). Moody's based its opinion on significant decreases in senior lien debt service coverage which fell below 1.0x in FY2009, lower than previously reported, and concerns that a financial recovery in FY2010 may not be enough to cover all debt obligations. The rating and outlook also considers the risk associated with the PRPA's need to refinance \$169.4 million of subordinate lien debt in 2010.

Most importantly, Moody's cited the "explicit and implicit financial support provided by the Government Development Bank for Puerto Rico, which provides liquidity support as needed, guarantees subordinate lien debt obligations, and provides continuous financial and management guidance. ***"The standalone credit strength of PRPA, if considered without the GDB support, would be substantially lower than the Baa3 headline rating"*** (emphasis added).

The strengths and weaknesses of the Ports Authority's rating, according to Moody's, are below:

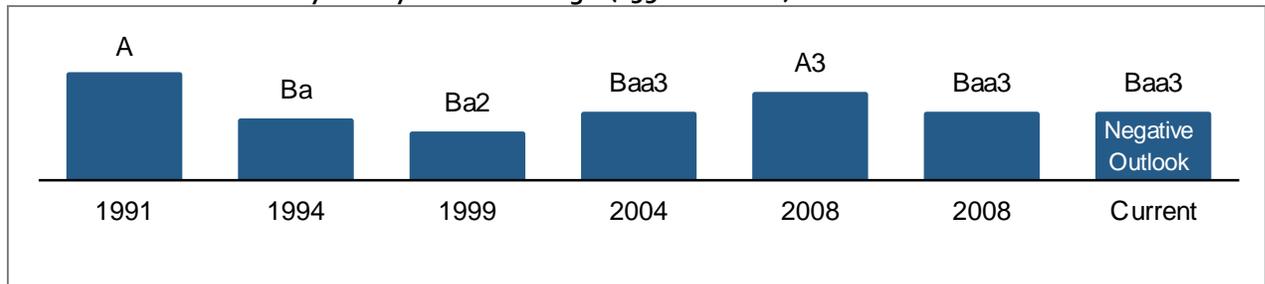
Strengths

- GDP provides an important source of liquidity for operating and capital needs
- Airport, cruise and cargo properties are highly essential to the Puerto Rico economy
- Limited senior lien debt outstanding. Projected senior lien debt service coverage for 2010 is projected by management to be 3.56x
- Enplanement growth has resumed with some strength since September 2009 due to increased service from several airlines

Weaknesses

- Financial metrics have worsened substantially in FY 2008 and FY 2009 reducing the authority's debt service coverage to below sum sufficient for FY 2009, though improvement is expected for 2010
- Reliance on the GDB for lines of credit instead of internal financial resources
- Need to refinance over \$169.4 million of subordinate lien debt in 2010 with concerns about the authority's access to market capital
- Revenues are exposed to volatile tourism, cargo, and cruise industries and have substantially declined in FY 2008 and FY 2009 due to strong declines in each; FY2010 revenues are showing marked improvement year-to-date
- Airline service levels declined sharply in FY2009 due to the economic downturn and the decision by American Airlines to reduce seat capacity to the airport by 45%, but steady growth has returned since September 2009

Puerto Rico Ports Authority Moody's Credit Rating ⁽¹⁾ (1991 – Current)



Source: Moody's Investor Service

Note: Excludes any rated offerings

(1) Represents the PRPA's insured rating, recognizing the explicit and implicit support provided by the Government Development Bank for Puerto Rico

S&P and Moody's rating is highly dependent on the Ports Authority's aviation operations (aviation represented 56% of operating revenues for the Port Authority in 2008), most of which exist at Luis Munoz Marin International Airport. AMR Corp.'s (parent company of American Airlines and American-Eagle) September 2008 announcement to reduce capacity by 45% at the airport effectively ended their use of the airport as a "hub airport." While some of this loss has been offset by JetBlue's increased operations, the overall levels of use at the Airport have declined. Moody's expectation for FY2010 is continued, modest decline in enplanements, but stabilizing going forward given the Airport's monopoly of air service to the island. The uncertainty surrounding future enplanements is increased with the ongoing renegotiation of the airport use agreement (excluding the separate American Airlines use agreement). Given the difficult economic terms, particularly in the airline industry, Moody's notes a "heightened potential that not all current carriers will sign the new agreement", which may further reduce future enplanements. The PRPA is actively working with the carriers on an extension of the current use agreement.

3.2.3. PRPA Financial Controls and Refinancing Risks

Beyond enplanements, which are direct drivers of revenue and expenses at the Airport, the credit agencies highlight the "considerable fluctuations" in financial operations at the Airport and the Ports Authority more broadly. S&P cites "cyclicality in operations, a lack of strict controls on operating expenses, difficulties in collecting receivables, and a growing use of lines of credit to support both operating and capital needs" as key factors in recent fluctuations. While the agencies acknowledge that new management is committed to "restoring the authority's finances by providing greater expense controls and looking to enhance revenues," there is considerable concern around the Authority's current reliance on the GDB lines of credit. As the size of the subordinate lien obligations have grown and the operational performance has diminished, the pressure on the credit profile has increased significantly. Currently, all of the subordinate debt is supported by letters of credit from the GDB with reimbursement terms. It would be very difficult for the PRPA to obtain financing on a standalone basis, without the support of the GDB.

Finally, Moody's highlights refinancing risk as a "mounting problem." \$169.4 million of the subordinate lien debt is due in FY2010 and refinancing discussions are ongoing. The Authority's ability to refinance these tranches of debt in today's market will be a key determinant to the Authority's rating going forward.

3.3. General overview of LMM

Luis Muñoz Marín International Airport is owned and managed by the Puerto Rico Ports Authority. According to the United States Federal Aviation Administration, LMM is classified as a medium hub facility, ranked 41st nationwide based on percentage of enplaned passengers.

History of Luis Muñoz Marín International Airport¹

In 1950, Puerto Rico's population had increased to 2,210,703, up 18.3% from 1940. Given this, the heavy transit of passengers en route to the United States by airplane, the promising future of Puerto Rico tourism and the economic progress resulting from the work of the Puerto Rico Industrial Development Company, the Ports Authority commissioned a study in 1951 that favored the construction of a new airport.

The Ports Authority hired Knappen-Tippet-Abbett-McCarthy of New York to design the new airport. The design was based on an estimate of passenger movement of 508,000 passengers in 1955 and 665,000 in 1960. Construction workers began leveling a 1,200-acre plot of land near the Isla Verde beach in the municipality of Carolina, which, up to that point, had been a mangroves and coconut field. In August 1952, the principal concrete runway (7,800 feet long) was finished, as well as the auxiliary runways.

Simultaneously, other facilities, such as the main six story building with a control tower, were built. The passenger terminal was made up of a series of three separate buildings connected to one another. The terminal included 10 gates for passenger airplanes, 4 for cargo aircrafts, and space for non-commercial aircraft. The Airport also had a 30-room hotel for airline crew members and passengers in transit, parking for 1,175 automobiles, fire and police stations, and a variety of restaurant and retail locations.

The development of the airport reached a cost of approximately \$15 million. The International Airport was inaugurated on May 20, 1955. The Puerto Rico International Airport, as it was called, was equipped with a modern landing and take off control equipment. This opened the road for tourism development in Puerto Rico.

In 1985, Bird Construction was engaged to continue the development of the International Airport. The engagement was pursuant to an agreement between the Ports Authority and American Airlines for the rehabilitation and expansion of the old gates and terminal space. Upon completion, American Airlines would occupy most of the renovated wing of the airport.

During the 1990s, large construction works were undertaken to comply with stricter codes and regulations by the Federal Aviation Administration. The Ports Authority also completed the connecting taxiways number 8 and 10. This allowed for two airplanes to cross over a bridge at the same time while automobiles pass underneath entering the Airport. With the increase in traffic over the years and the height of new terminal buildings, the Airport also built a new control tower, which still today is one of the tallest structures in the Island.

Overview of Airport operations

LMM's core operations, through which it derives its principal source of revenue, consist of:

- **Airline services** – Providing origination and destination services for 25 commercial and international airlines through 4 terminals, including Terminal A (American Airlines is the largest airline served, representing 46% of enplaned passengers as of FY09)
 - LMM plans to open a new Terminal A adding 7 additional gates for airlines in October 2010
- **Air cargo services** – Serving air cargo service providers – LMM handled over 200,000 short tons of cargo in FY09
- **Airport parking services** – LMM can accommodate up to 5,000 parking spaces
- **Commercial services** – Providing other commercial services for airline passengers, including various retail, food and beverage outlets and car rental services

¹ This section is based on the book *Una de cal y otra de Arena Panorama Histórico de la Construcción en Puerto Rico: 1493-2004* by Guillermo A. Baralt, 2008.

- **Other** – As an airport regulated by the FAA, LMM also collects Passenger Facility Charges of \$4.50 per passenger. This revenue source offsets the cost of certain approved capital projects to maintain or upgrade the Airport for the benefit of passengers and airlines



To successfully execute these core operations, LMM also performs several key support functions that include management, administrative and specialized processes that are essential to the operation of an airport.

Under the current framework, commercial airlines and air cargo companies operate under a rates and charges agreement in which LMM is paid for airlines’ access to its runways, gates and terminals. The rates are reset each year and are based on take-off weight. Rates also include compensation for debt incurred by the airport in accordance with certain capital expenditure projects needed at the airport. LMM uses a third party consultancy in assisting with setting the actual rates with the airlines.

The airport parking services are based on a fixed fee per car parked; however, LMM pays a third-party to manage the day-to-day operations of the airport parking lot. With commercial vendors, LMM has fixed rent or revenue sharing contracts, which can last up to three years.

LMM is owned and operated by the PRPA, as the largest component of the PRPA’s aviation operations. The PRPA provides administrative, financial, maintenance and planning services to the Airport. The PRPA “assigns” through an allocation methodology the associated cost of these services to the Airport.

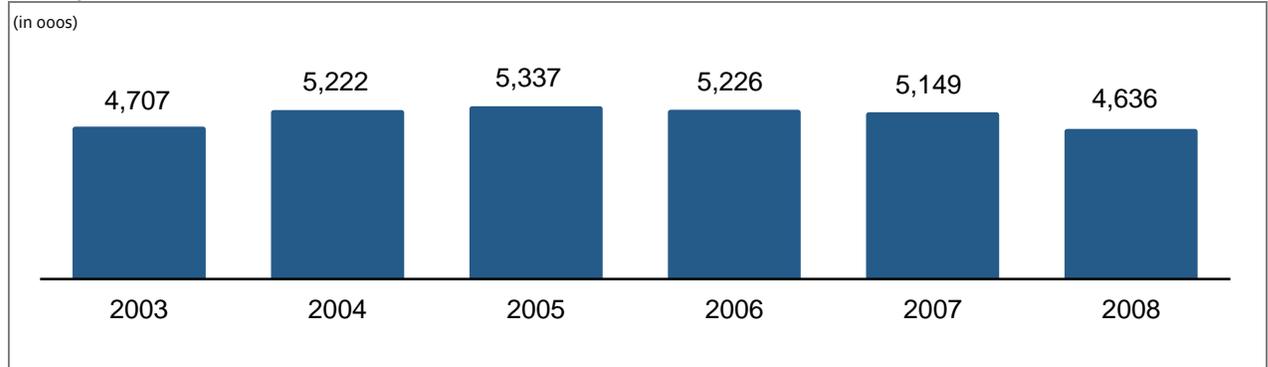
The core services that LMM provides to the traveling public are:

- Airline operations to and from Puerto Rico to major US and international destinations;
- A positive customer experience while using the airport through auxiliary services (i.e., car parking, retail and restaurants);
- A safe, regulated transportation environment;
- Cargo services which bring parcels, supplies, food and other essential items to Puerto Rico; and
- A military presence with the Puerto Rico Air National Guard facilities located at LMM.

3.4. Service delivery plan of LMM

There has been a decline in passenger traffic at the LMM from 5.3 million enplanements in CY2005 to 4.6 million in CY2008 due to service levels and the decision by American Airlines to reduce seat capacity to the airport by 45% and the inability to develop an alternative long-term growth strategy.

CY Enplanements for LMM



Source: FAA CATS Database, representing calendar year enplanements

Note: Enplanements is defined as number of passengers boarding a flight, including origination, stopovers and connections

Additional reasons for the decline in passenger movement are:

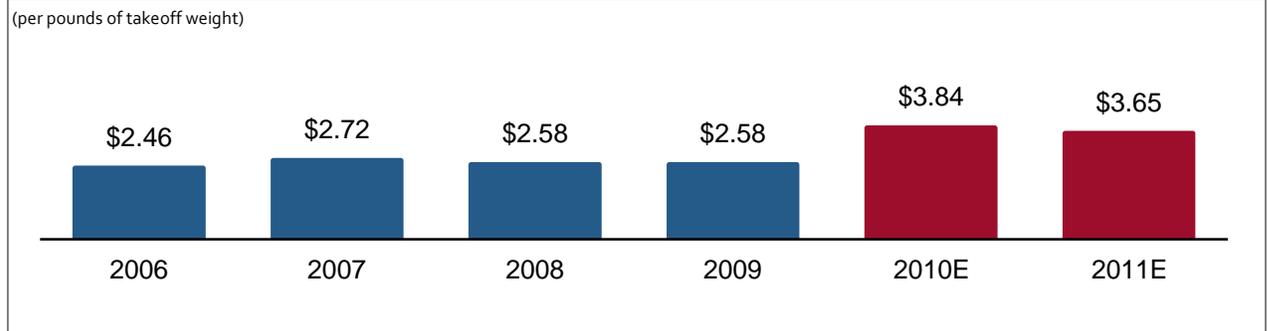
- Management challenges at LMM
- Greater competition from other airports for transfer passengers
- Contraction of the Puerto Rico economy
- Decline in tourism travel by United States residents
- Greater competition for visitors from other Caribbean destinations

LMM's performance has also lagged key Caribbean and Latin American peers in total passenger growth. During the period from 2005 to 2008, the number of passengers in the two main airports in the Dominican Republic grew by 18%. Over the same period, LMM passenger traffic declined by approximately 13%. Costa Rica represents an attractive, low-cost air travel destination for Europeans. According to Aeropuertos Dominicanos Siglo XXI, 39% of foreign visitors to the Dominican Republic in 2008 flew in from Europe. This represented an increase of 8%, whereas European traffic to Puerto Rico declined by 1% over the same period.

Further, Miami International Airport, which is a strong hub for the Caribbean, Central and South American saw its total passenger traffic rise by 1% in 2008, while LMM's total passenger traffic declined by 10%.

The Airport has been unable to control costs, as seen by the rise in landing fees. High landing fees make the Airport less attractive to new airlines. Financial efficiency will be a major source of value for a PPP partner, as the decreased landing fees would make LMM more competitive with other airports and potentially increase traffic.

Signatory landing fees



Source: Puerto Rico Ports Authority

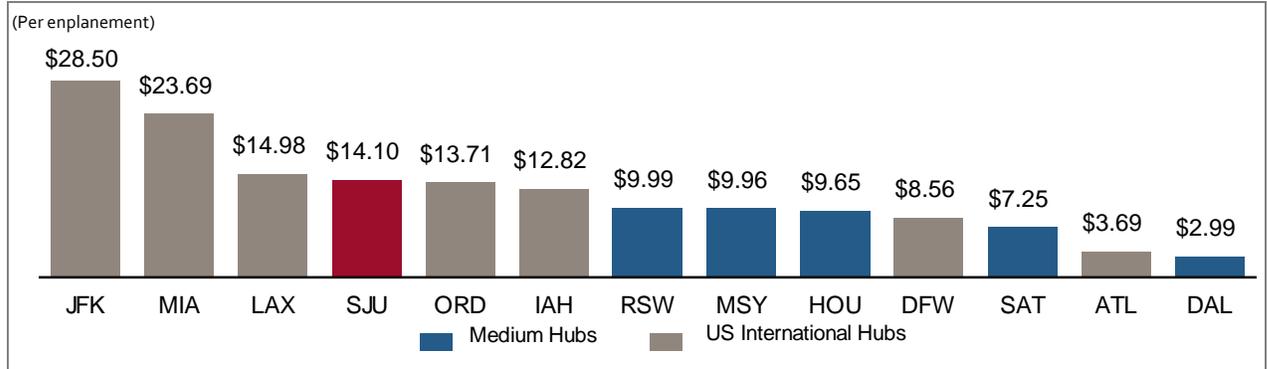
Note: 2010 and 2011 represent mid-year and initial estimates, respectively

While better airport management would have little impact on the volume of Puerto Rican residents travelling abroad, tourist travellers coming from abroad are impacted by better airport management, particularly to the extent that the number of flights increases and there are more convenient flight schedules.

One means for airports to derive revenues is through charges associated with aeronautical ("aero") activities. Aero charges are levied for the use of an airport's runway, apron and terminal facilities. Landing charges are typically based on the weight of the aircraft and terminal charges are generally levied based on the number of passengers at time of departure.

As the following chart illustrates, LMM generates significant aero revenue per enplanement, over 40% more than other medium hub airports. However, the rising costs to operate, and subsequent increase in aero revenues, may have led some airlines, including American Airlines, to reduce capacity. LMM remains 37% cheaper than the closest international hub (MIA), but many airlines may consider offering convenient flight schedules to airports which are less expensive to operate out of.

Airline revenue

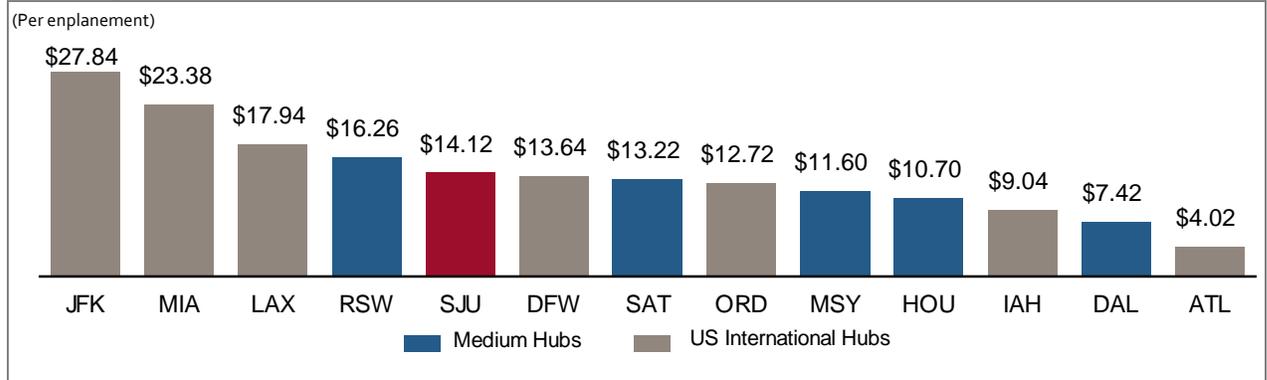


Source: Federal Aviation Administration

Note: 2008 data

While LMM does generate significant aero revenue, the Airport has very high operating costs. The chart below shows that LMM has the second highest operating expense per enplanement among comparable medium hubs with levels near major US International Hubs. The high operating expenses have likely led to higher landing fees for airlines and contributed to the reduction in passenger volume, thus worsening the Airport's financial and operational situation.

Operating expenses

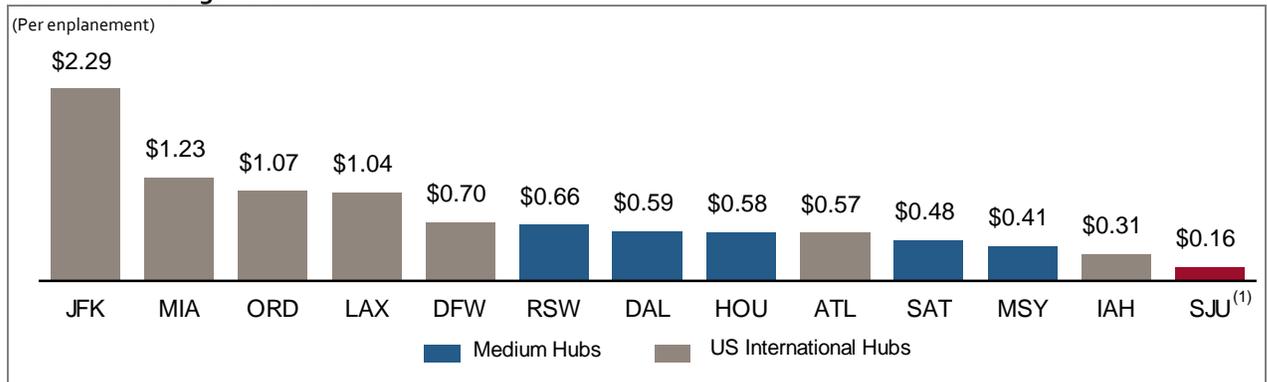


Source: Federal Aviation Administration
 Note: 2008 data

Further, LMM has failed to establish significant non-aero revenue sources, a key to operational and financial success for many airports.

The lack of quality dining options in the airport is seen in a mere \$0.16 of food and beverage revenue per enplanement. As the busiest airport in the Caribbean, it is important to offer satisfactory food and beverage options. Improved food and beverage options would likely generate significant revenue, as LMM serves as a major transit airport. In-transit travellers would likely take advantage of improved dining, as seen at other transit airports (JFK, LAX, MIA and ORD). Further, higher quality food and beverage options would improve passenger experience, causing more airlines to offer convenient flight schedules, and thus more visitors.

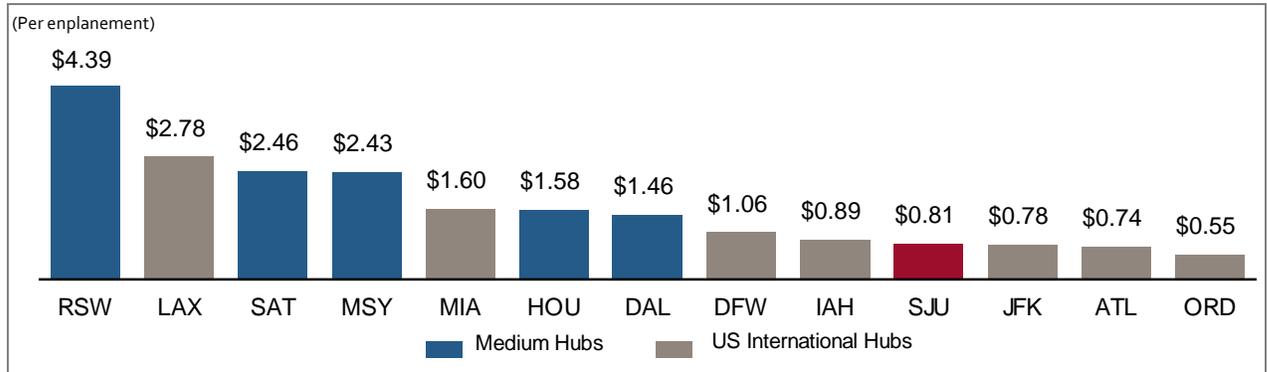
Food and Beverage revenue



Source: Federal Aviation Administration
 Note: 2008 data
 (1) 2007 food and beverage revenue per enplanement due to negative revenue in 2008

Two other important non-aero revenue sources are car rental and car parking. Again, LMM severely lags its peers. This could be an area of significant value creation opportunity at LMM.

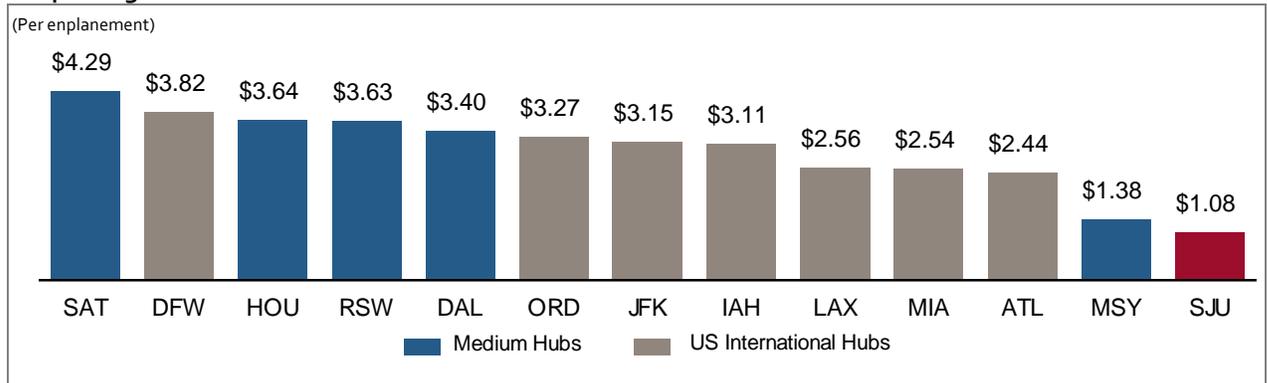
Car rental revenue



Source: Federal Aviation Administration
 Note: 2008 data

While many tourists visiting the island rely on taxis to get to their respective hotels / cruise ships, increased awareness of tourist activities on the Island could lead to improved car rental revenue. A private concessionaire would be inclined to promote the many tourism activities around the Island, which would ultimately benefit the local communities of Puerto Rico and the broader economy through gross product, tax revenues and job creation.

Car parking revenue



Source: Federal Aviation Administration

The main cause of minimal car parking revenue is poor management leading to mis-pricing and inadequate record keeping. A private concessionaire would continue with the PRPA's plan to install CCTV cameras to monitor attendants and cash registers. Also, they would benchmark parking facilities against comparable airports to ensure the competitiveness of parking rates at LMM.

The significant reduction in passenger volume and construction issues has delayed the opening of the newly constructed Terminal A. Further, the Terminal is behind schedule as the baggage system has not been completed. The PRPA does not anticipate opening Terminal A until October 2010. Leaving the space empty is inefficient for the PRPA as they have incurred the costs to build and are unable to fully charge airlines for use.

This new space offers attractive terminal area for an airline, and must be utilized. By improving operations, becoming more efficient and charging competitive landing fees, airlines will increase capacity to LMM and Terminal A will be utilized

3.5. LMM opportunities

As previously mentioned, passenger traffic at LMM has been declining since 2006. The Airport represents an important infrastructure asset for Puerto Rico's tourism and economic development. Unfortunately, LMM is currently being under utilized and mismanaged. There are several key opportunities for LMM to improve from the current service delivery method:

LMM as a major international hub

The strategic location and sea level condition of LMM make it an ideal destination to serve as a major hub between North America and Europe to South America, Central America and the Caribbean. As LMM reaches its full potential in this area, the profile of Puerto Rico as a major Caribbean destination could be enhanced, the Airport traffic could increase and the number of destinations could improve. A major hub facility improves the number of flights and convenience of flight schedules; these can be a major attraction tool for visitors and transfer passengers. The resulting new traffic from developing LMM as a major hub will contribute positively to the top line revenue of this airport and the broader Puerto Rican economy through gross product, tax revenues and job creation.

Higher commercial revenues

As highlighted above, LMM has significant upside opportunities to improve its current commercial offering and layout to increase passenger spending at the Airport. The current offering at the Airport fails to capture the opportunity that exists in commercial revenues. LMM's profile could be improved by making changes to the status quo.

Operational transparency

Currently, it is difficult to estimate the real costs of operating LMM. By separating the operations of this Airport from the PRPA, it would be easier to determine and manage the costs of operating the facility. Bringing an operator with significant expertise could integrate some of the most relevant international best-practices in airport management at LMM.

Improve airport amenities and services

Improving LMM's amenities and services should be one of the key focuses of Airport management. There is significant opportunity to improve the amenities and services offered at LMM. This will directly benefit the residents of Puerto Rico and other travellers at the airport. These improvements will include modern technology, more retail, food and beverage offerings and additional amenities within the terminals.

Additional opportunities

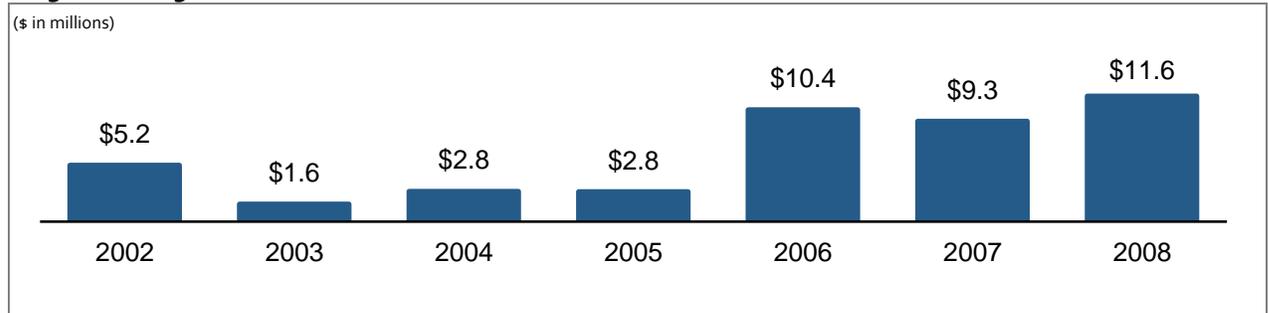
In addition to the aforementioned strategic and financial initiatives at the Airport, there are a number of projects under consideration at the Airport that may present additional opportunity. Airport management and the Ports Authority have outlined these below:

Cargo facilities

Currently, Luis Munoz Marin has the largest air cargo operations in Puerto Rico and according to the P3 Authority, demand forecasts project 950 million short tons of cargo to be flown by 2024. The Airport serves 14 air cargo services, primarily represented by FedEx, UPS, USPS and commercial flights. While the airport has seen significant growth in its

cargo and hangar revenue since 2002, the Port Authority is currently evaluating options regarding its Cargo Air Facilities (referred to as CAF1, CAF2 and CAF3).

Cargo and hangar revenue (2002 – 2008)



Source: Puerto Rico Public-Private Partnerships Authority

Puerto Rico National Guard space

Currently, the Puerto Rico National Guard utilizes a 126-acre space at the North-East end of the airport for its air fleet needs.

3.6. Analysis of service needs

Based on the previously mentioned information, there are several needs that the PRPA should address to meet the objectives of this Project:

- Maintain and improved LMM current service levels
- Adhere to the highest level of safety and quality standards
- Develop and market LMM as a major hub
- Increase commercial revenues at the airport
- Improve operations and financial efficiency
- Enhance current service offerings and airport amenities
- Raise the profile of Puerto Rico as the Caribbean destination of choice

3.7. Project scope of work

The Project consists of the identification of a consortium that would partner with the PRPA to operate a concession of LMM in which:

- The consortium will typically include a private investor that may include an infrastructure fund or a pension plan, an airport operator with significant experience in operating airports internationally and a potential construction company to form a consortium
- The airport operator assumes day-to-day management of the airport and reserves the ability to alter day-to-day operations for commercial maximization and benefit of LMM
- This consortium will be in charge of executing the current investment plan and the new business plan to develop and meet the objectives mentioned above

The PRPA and P3 Authority envision that a private consortium will address the service needs at LMM by implementing some set of the following:

- A fulsome capital improvement plan that adequately addresses the infrastructure needs at LMM. A summary of the PRPA’s current capital improvement plan (2012 – 2014) is below:

LMM planned capital improvements

(\$ in millions)

	2012	2013	2014
Reconstruction of Taxiway Sierra	\$24.0	\$18.0	–
Improvements Runway 8-26	–	5.0	18.0
Extension to Taxiway Sierra	10.1	–	–
Water Storage Tanks & Pump Station	1.3	–	–
Cargo Access Road & Sanitary System	3.9	–	–
Expansion of Midfield Taxiway (Dual)	–	4.7	–
Kilo Apron Expansion	2.5	1.3	–
Misc. Repairs and Maintenance	0.3	0.3	–
Total	\$42.3	\$29.3	\$18.0

Source: PRPA.

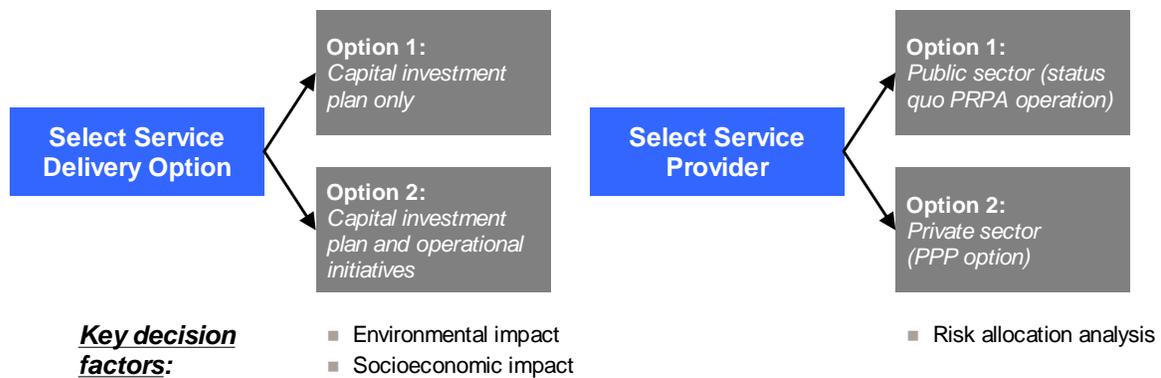
- A complete review of current commercial activities at the Airport and identification and execution of new opportunities
- A complete review of the current financial structure at the Airport and increasing financial flexibility to adapt to the changing operating environment

4. Service delivery options analysis

4.1. Introduction

This section presents service delivery and service provider options for the Project and the benefits and drawbacks of each one of them. A preferred option is recommended and an appropriate risk analysis is made that supports the recommendation. In this risk analysis, project risks are defined and allocated to either the public (status quo operation by the PRPA), the private (PPP option), or are shared.

The analysis assumes a two tiered decision tree:



The Project seeks to maximize the benefits (and mitigate drawbacks) from the impact of selecting a service delivery option. It also seeks to appropriately allocate risk to the service provider best able to bear the relevant risks.

A summary of the options outcome is below:

		Service Provider Option	
		1	2
Service Delivery Option	2	<ul style="list-style-type: none"> ■ Improved operations but uncertainty whether PRPA can fully execute revenue and cost initiatives as well as capital improvements 	<ul style="list-style-type: none"> ■ Delivery of world-class operating expertise and third-party financial backing
	1	<ul style="list-style-type: none"> ■ Status quo 	<ul style="list-style-type: none"> ■ Unlikely outcome – PPP partner is incentivized to drive results

4.2. Service delivery options

Considering the service needs at LMM and the opportunities that exist to enhance both the value of the Airport and the customer experience, as outlined in Section 3, there are two delivery options that could help the PRPA achieve its objectives. These options are:

1. Implement a capital investment plan at LMM to upgrade the existing infrastructure; or,
2. Implement a capital investment plan at LMM to upgrade the existing infrastructure and operational initiatives aimed at increasing revenues and increasing financial flexibility.

4.3. Service delivery option 1: Capital investment plan

Option 1 entails implementing a capital investment plan for the maintenance and upgrade of current Airport infrastructure.

The operator of the Airport, either the public or private sector, would be responsible for defining the capital investment needs as well as financing and executing the plan. The plan would need to address the opportunities and shortcomings outlined in Section 3. Examples of projects, as presented in the PRPA's current capital investment plan, may include:

- Reconstruction of Taxiway Sierra
- Improvements to Runway 8-26
- Extension to Taxiway Sierra
- Cargo access road and sanitary system
- New Terminal A building
- Security fence and security access road
- South GA access road and utilities
- Access control and CCTV replacement
- Water storage tanks and pump station
- Expansion of Midfield Taxiway
- Kilo apron expansion
- Improvements to Terminal D

The financing of these projects is likely to be largely through Passenger Facility Charges ("PFCs"). However, if PFCs are not available to fund projects for any reason, the operator will be forced to find alternative financing. In that case, the cost of financing is likely to be much less by a concessionaire than the PRPA.

The main benefit of this option is that infrastructure investment is vital to maintaining:

- Runways, taxiways, control facilities and technology that meets or exceeds FAA regulations
- The attractiveness of the Airport to airlines, both existing and potential new airlines
- The attractiveness of the Airport to retailers, car rental companies and other auxiliary service providers
- A positive customer experience throughout the Airport
- The initial gateway for most of Puerto Rico's tourists

The main drawbacks of this option are:

- Capital investment without revenue or cost management initiatives fails to "protect" the investment or maximize the usefulness of the invested asset. Financial efficiency enables a positive return on the investment.
- The potential cost of financing the project may be dependent on GDB lines or municipal and capital markets if PFCs are not authorized to be used. This cost may be higher than expected.
- A capital investment plan does not address the financial inefficiency that currently exists at the Airport.

4.4. Service delivery option 2: Capital investment plan and operational initiatives

Option 2 entails both a capital improvement plan and operational initiatives. The capital improvement plan is the same as Option 1 (or may be enhanced due to superior financial performance of the Airport). The operational initiatives would be focused on improving operational efficiency to drive improved cash flow at the Airport.

Initiatives to drive revenues at the Airport may include:

- Improving on-airport parking options, including market-based pricing and financial controls to monitor receipts
- Improving advertising space both within terminals and around the Airport (ie. billboards) and renting space to advertising agencies
- Examining current passenger flow patterns within terminals to ensure that retail and food & beverage outlets are placed in prime locations to attract passenger spending
- Examine space utilization within terminals to maximize retail tenants
- Capital investments related to Fixed Base Operators (“FBO”) space and / or cargo facilities to attract additional rent-paying operators / carriers

Areas where financial efficiency can be improved include:

- More flexible cost structure to help manage through difficult operating environments
- Controlling general and administrative spending
- Monitoring expense contracts (ie. professional services, security, cleaning, etc.)
- Utilizing best practices related to airport management
- Efficient capital structure with adequate debt service coverage

Another aspect of managing revenues and expenses is an examination of the current rates and charges regime in place at the Airport. The rate setting process is the way that the Airport charges the airlines for use of the facilities including runways, taxiways, terminals, etc. The current process and methodology, which is governed by Section 336(l) of the Puerto Rico Ports Authority Act, is complicated and requires significant time and resources on the part of the PRPA, the signatory airlines and 3rd party consultants. Either through a PPP or a commissioned review, this process and the methodology should be examined to ensure that airline charges are properly offsetting costs.

The benefits of this option are:

- Fully addresses the needs of the Airport through capital investment and revenue and cost management
- Improved management of revenue and expenses enables positive return from capital investments
- Additional benefit of looking into and improving the rate setting process and methodology for properly matching airline charges to expenses
- Revenue opportunities related to retail and food and beverage outlets are likely to improve the customer experience
- Full-scale review of Airport operations is likely to uncover additional opportunities at the Airport

The main drawbacks of this option are:

- A significant amount of time and dedicated resources would be needed to identify revenue opportunities and leverage in the cost structure, as well as implement improvements
- Airport management expertise would be needed to effectively address Option 2
- The potential cost of financing the project may be dependent on GDB lines or municipal and capital markets if PFCs are not authorized to be used. This cost may be higher than expected. Cost of financing capital projects.

4.5. Environmental impact

The proposed capital investment plan and financial efficiency initiatives will have limited environmental impact to the surrounding areas. If, however, these initiatives result in increased activity at the airport, plane traffic and noise may increase.

The potential gas leakage liability at LMM, which has been charged to the airlines through the rate setting methodology, may present additional costs for the Airport operator. Under the current arrangement, the PRPA, possibly along with the airlines, would be responsible for the liability. In a PPP, a concessionaire would not take ownership of the land and is likely to seek indemnification from the PRPA for any potential liability.

Regardless of the service delivery option and service delivery provider selected, the responsible party must remain committed to maintaining adequate environmental protections, even with an increase in traffic.

4.6. Socioeconomic impact

The Project has several positive socioeconomic impacts for LMM travellers and Puerto Rico in general. Investment in the infrastructure of the Airport and improvements in the financial profile of the Airport may provide the following benefits:

- **Increase airport traffic** – Increased traffic at LMM increases the revenue potential of retail and auxiliary operations. Traffic may be increased by existing carriers or actively soliciting new and diverse airlines to utilize LMM, leading to a greater selection of airlines and destinations for Puerto Rican residents.
- **Diversify carriers' presence** – American and American Eagle account for approximately 45% of the commercial activity at LMM. Increasing the diversity of carriers and flight origins at the Airport (currently, predominantly the U.S. Northeast) is essential for the stability of the airport's traffic profile.
- **Increase number of destinations** – Currently, LMM's destination offering is mainly concentrated on the East Coast of the U.S. As new flights from more destinations are operated from San Juan, Puerto Rico, the Island could become more appealing to visitors that prefer to travel non-stop. Additionally, having more connections to different destinations may enhance the profile of the port of San Juan as a main hub of cruise ships in the eastern Caribbean.
- **Enhance Puerto Rico's profile as a major Caribbean destination** – Currently, there is significant competition from other regional destinations in the Caribbean. The Dominican Republic and Jamaica, some of the largest competitors of Puerto Rico tourism in the region, have granted concessions to operate their major airports and improve their facilities. Both destinations also enjoy more diversified flight origins than LMM. Another major challenge to the tourism industry in Puerto Rico is the potential relaxation of the travel restrictions of U.S. citizens to Cuba. In order to better compete regionally, it is imperative to improve the airport operations, increase passenger traffic, add new destinations and diversify carriers to the airport.
- **Develop local operational know-how** – The Project will aid employment opportunities at the Airport. Local financial institutions, legal counsel and several other business services providers will be used to provide services to LMM, and potentially a concessionaire, related to this Project.
- **Improve airport amenities and services** – Airport users would benefit as LMM's amenities and services improve. All users would have a more pleasant experience in the airport. LMM is the first impression that visitors to the Island have and thus providing excellent services improves the image of Puerto Rico overall.
- **Development of a world-class airport** – The administration of the proposed Project would significantly improve the infrastructure and operations at LMM.
- **Improve financial situation of the PRPA** – PRPA could potentially increase revenues, reduce costs and improve its credit profile. In a PPP, it would be able to reduce interest expense costs after using proceeds to pay down debt.

4.7. Selection of service delivery option

Considering the benefits, drawbacks and environmental and socioeconomic impacts, PRPA believes that Option 2 is the best service delivery option, given that it fully addresses the issues at the Airport and fulfils the objectives of the Project. Option 2 is favored because:

- **Fully addresses the needs of the Airport** – Capital investment and revenue and cost management initiatives address both the infrastructure and financial profile issues that exist at the Airport today.
- **Aligns the operation of the Airport with the needs of travellers** – Simply investing in infrastructure at the Airport without ongoing management of its operation fails to maximize the return on the investment which ultimately benefits the travelling public.
- **Infrastructure makes the Airport more attractive to carriers** – Upgraded infrastructure, particularly aeronautical infrastructure (ie. runways, taxiways, etc.) makes LMM an attractive partner for airlines looking to build a Caribbean presence.
- **Revenue and cost management makes the Airport more attractive to carriers** – A strong financial performance will be attractive to the airline partners seeking stable costs and performance. Further, redeveloping the rate setting methodology to make it more transparent will be appreciated by both existing and potential carriers.
- **Improvement of customer experience** – New revenue opportunities, particularly retail and food and beverage outlets, will benefit the customer and make their experience at the Airport more enjoyable. This will also enhance Puerto Rico’s profile as the preferred vacation destination in the Caribbean.

4.8. Service provider options

With the selection of service delivery option 2 (providing capital investment at LMM and implementing revenue generation and cost control strategies), the PRPA must consider the service provider of the Project. Considering the needs at LMM and the selection of service delivery option 2, there are two service provider options that could help the PRPA achieve its objectives. These options are:

1. Publicly-funded and operated upgrade of airport and airport-related commercial facilities; or,
2. A PPP whereby PRPA enters into a long-term lease with a private third-party Concessionaire and airport operator in exchange for upfront compensation.

4.8.1. Option 1: Upgrade of Airport and Airport-Related Commercial Facilities Funded and Executed by the PRPA and Financed by the Government of Puerto Rico

Option 1 entails upgrading existing airport facilities, including commercial operations, to drive revenue yields per passenger equivalent to other regional and / or continental U.S.-based medium hub airports. Given the financial challenges at the PRPA, the Government Development Bank of Puerto Rico (“GDB”) would have to finance the upgrades, which would include upgrading terminals, runways, ramps and other airport facilities to attract and accommodate both existing and new commercial airlines to operate at LMM. In addition, the Government Development Bank would also finance certain commercial upgrades including parking facilities expansion and attracting key retailers to LMM to maximize revenue potential as a key tourism hub in the region. PRPA and GDB would address debt obligations pursuant to the airport and commercial facility upgrades through additional revenues to be obtained as a result of the airport investments. In this option, there is no assumed private capital investment. Therefore, all of the risk is retained by the PRPA.

The main benefits of this option are:

- Allows the PRPA to retain operational control, which would only be a benefit if the financial situation at the PRPA changes dramatically
- PRPA could leverage the cash flows of the airport, pro forma for the investment, to service debt obligations pursuant to LMM

The main drawbacks of this option are:

- PRPA may retain contractors to assist in LMM upgrades, but ultimate risk of operatorship and resulting cash flows is retained by the PRPA (it is unlikely that contractors will accept the risk of any performance-based contract whereby their compensation is solely based on the revenue enhancements achieved through the investments since they would not control the other main commercial activities of the airport)
- Since the compensation structure is not performance-based, contractor payments are not aligned with the success of the upgrades
- Option may not result in higher revenue yields to service financing obligations pursuant to airport upgrade investments – would result in meaningful incremental debt burden on Puerto Rico and weaken the credit profile of the Government Development Bank
- Given the scope of projects needed to upgrade the airport, PRPA would need to procure the expertise of multiple contractors through multiple, lengthy RFP/RFQ processes
- Inability to leverage credit profile of a new Concessionaire and reduce financing costs
- Current agreement with airlines operating at LMM would not be materially altered – inability for PRPA to leverage airlines’ capital to make investments at the airport that may ultimately benefit the airlines
- Inability to leverage operational expertise of a third-party
- Opportunity cost of not monetizing the Airport

4.8.2. Option 2 – PRPA enters into a PPP with Private Concessionaire and Airport Operator

Option 2 entails entering into a PPP with an independent third-party private Concessionaire and Airport Operator. Under this option, the Concessionaire would enter into a long-term lease for the rights to operate LMM. The Concessionaire would typically consist of a consortium of private investors, which are predominantly large, well-funded infrastructure funds, working with leading independent airport operators. The Concessionaire would compensate PRPA for the right to operate LMM for the lease period through a one-time upfront payment. PRPA and the Government Development Bank would utilize the gross proceeds to defease financing raised pursuant to the airport. The remaining proceeds could be deployed toward other infrastructure projects in Puerto Rico. Prior to finalizing an arrangement with a Concessionaire, PRPA would also likely require a binding agreement from the commercial airlines operating at LMM governing the rates and charges structure through which the airport is compensated for use of the runways, ramps and terminals. After the closing of the transaction, the airport operator and Concessionaire would self finance upgrades to the airport and retain the economic benefit of any such upgrades. Neither PRPA nor the Government Development Bank would retain any rights to the economic output of LMM.

This option is considered a PPP because private capital is being used to finance the upgrade of the airport and it allocates the risk of such upgrades to the Concessionaire. Therefore, the majority of the risk is then shifted from the public sector to the private sector.

The main benefits of this option are:

- Allows Puerto Rico to retain the ownership of LMM
- Enables PRPA to obtain a large upfront cash payment
- Proceeds can be utilized to defease high cost capital tied to the airport, driving substantial interest cost savings, as well as other potential infrastructure projects

- Upgrades the facilities for the benefit of the residents of Puerto Rico
- Lease structure shifts majority of operating risk to the private sector with certain safeguards to regain operatorship if Concessionaire fails to meet pre-determined operational and / or financial obligations
- Enables structured approach to partner with existing and new commercial airlines
- Partnership with qualified, experienced and well-funded third party likely to drive higher passenger traffic and resulting tax revenue for Puerto Rico
- Operator will be responsible for all the future liabilities arising and attributable to LMM

The main drawbacks of this option are:

- PRPA will no longer receive any economics from the airport as a result of the transaction, however, PRPA will no longer have to service outstanding debt related to LMM

4.9. Risk allocation analysis

When considering whether the public sector or the private sector is best suited to implement a capital investment plan and operational management initiatives, the PRPA must choose the operator that is best suited to manage the relevant risks. PRPA has identified a number of risks that are relevant to this decision. These risks are listed and briefly identified below:

1. Changes in regulation – The airport business is highly regulated and it is very difficult to predict changes in regulation that may severely impact the operations of LMM. The FAA, TSA, U.S. Department of Homeland Security, among other federal agencies, oversee the operations of this facility. New regulations can become effective and prevent certain businesses, activities, traffic, etc. This risk is assumed by the operator of the airport, but would affect the Government in either scenario.
2. Capacity to execute the business plan – The airport operator would be responsible to execute the business plan for LMM to fully develop its revenue and value potential. Both the public and private sector could experience losses in case the proposed business plan is not executed.
3. Ability to generate additional revenue streams – If the airport operator fails to generate additional revenue streams to complement current operations, potential value upside might not be achieved.
4. Ability to manage expenses – The operator will be responsible to control and manage the expenses of LMM. Costs overruns will be assumed by the operator.
5. Operational – The operator will be responsible for managing the risks associated with the daily operations of this facility. It will also be responsible for assuming the typical operational costs associated to the management of LMM, including those currently provided by the PRPA, in the event of a private sector operator.
6. Capital investments – The operator will develop a capital improvement plan for the Airport and will be solely responsible to assume these investments.
7. Airline relationships – For the successful operation of an airport, it is essential to maintain and improve the relationships with all the airlines serving or potentially serving LMM. If a key relationship is severed the operator will assume the risk of any potential revenue loss or additional costs.
8. Loss of a key airline / tenant – The loss of one or more of LMM's key tenants could result in a loss of a significant amount of the operator's revenues. This risk will be assumed by the operator.
9. Customer service – Minimum quality of service levels will have to be guaranteed by the operator per an established use agreement.

10. Competition from other Caribbean destinations – Competition from other tourist destinations could adversely affect LMM’s business. The principal driver of revenues of an airport is the number of passenger using an airport. If for factors beyond the control of the operator, this number drops the operator could suffer reduced revenues. The traffic volume could be impacted by the perception of attractiveness, affordability and accessibility of Puerto Rico versus similar destinations in the region.
11. International events – International events such as the SARS, H1N1 and global conflict, have negative impact on air travel and could cause a reduction in air traffic. The airport operator would assume the financial risk in this matter. However, any socioeconomic impact from such an event would be shared by both the PRPA and the operator.
12. Natural disasters – LMM airport is located in an area with significant risks for hurricanes and typical tropical torrential rain. Also Puerto Rico has relevant seismic activity. Natural disasters may impede operations, damage infrastructure needed to perform the airport operations or can adversely affect the destination in general. In case of any of these events the traffic volume to LMM could decrease. Usually it is possible for the operator to insure against the damages to the property but the losses due to losses in revenues are not insurable. This risk will be assumed by the operator.
13. Bankruptcy of the owner / operator – Assuming private sector participation, the PRPA would assume operation of the Airport in the event of uncured default or bankruptcy of the private operator. PRPA would be no worse off than in the status quo case, as it would be operating the Airport either way. However, in the case of a successful PPP, PRPA would have received the proceeds from the lease and paid down its debt. Under public operatorship, bankruptcy of the PRPA would adversely affect the Government Development Bank and likely Puerto Rico more broadly.

4.9.1. Risk allocation matrix for instituting the capital investment plan and operational management initiatives by the Government of Puerto Rico (status quo)

Risk allocation matrix for service provider option 1

Risk	PRPA	Private	Shared
1. Changes in regulation	√		
2. Capacity to execute the business plan	√		
3. Ability to generate additional revenue streams	√		
4. Ability to manage expenses	√		
5. Operational	√		
6. Capital investments	√		
7. Airline relationships	√		
8. Loss of a key airline / tenant	√		
9. Customer service	√		
10. Competition from other Caribbean destinations	√		
11. International events	√		
12. Natural disasters	√		
13. Bankruptcy of the owner / operator	N/A ⁽¹⁾		

(1) Given GDB support, this is effectively non-applicable

4.9.2. Risk allocation matrix for instituting the capital investment plan and operational management initiatives by a private partner (PPP)

Risk allocation matrix for service provider option 2

Risk	PRPA	Private	Shared
1. Changes in regulation		√	
2. Capacity to execute the business plan		√	
3. Ability to generate additional revenue streams		√	
4. Ability to manage expenses		√	
5. Operational		√	
6. Capital investments		√	
7. Airline relationships		√	
8. Loss of a key airline / tenant		√	
9. Customer service		√	
10. Competition from other Caribbean destinations			√
11. International events			√
12. Natural disasters			√
13. Bankruptcy of the owner / operator		√	

4.10. Selection of service provider

Considering the benefits, drawbacks and results of the risk analysis of the two service provider options, PRPA believes that the private sector is best suited for the service delivery. The private sector is favored because:

- Allows PRPA to retain ownership of the Asset, while leveraging private sector operational expertise
- Enables PRPA to obtain a large upfront cash payment
- Shifts the majority of the risk away from the PRPA to the private sector, reducing the exposure of the Puerto Rican government
- Enables structured approach to partner with existing and new commercial airlines
- Frees PRPA of future LMM liabilities.
- Improves the operations of an important, currently under utilized asset through world-class operational expertise

4.11. Contracting options analysis

A long-term lease typically includes three or four principal agreements involving the airlines, Concessionaire, Airport Operator and PRPA.

Agreements between Airlines, the Concessionaire and the PRPA

- New Airport Use Agreement
 - Potentially a 20-25 year agreement
 - Governs rates and charges structure for the airport
 - Governs airlines' contribution to future capex projects – Concessionaire is obligated to continue funding deemed necessary for the airlines and in the best interest of the flying public
- Operating Standards Agreement
 - Governs day-to-day operations of the airport as mandated by the U.S. Transportation and Security Administration
 - Ties to the Concession and Lease Agreement whereby Puerto Rico can re-assume control of the Airport if the operator is unable or unwilling to comply with the Operating Standards Agreement

Agreements between the Concession, Airport Operator and the PRPA

- Concession and Lease Agreement
 - 50 year agreement (maximum term)
 - Operatorship of the airport is transferred over to the Concessionaire and the Airport Operator
 - Concessionaire is typically a private investor and the Airport Operator is a third-party firm with significant experience in operating airports internationally
 - Airport Operator assumes day-to-day management of the airport and reserves the ability to alter day-to-day operations in a manner that maximizes its economic benefit pursuant to the transaction while preserving the standards defined by the PRPA
 - PRPA would receive a significant upfront payment, the proceeds of which would be applied toward debt defeasance and infrastructure projects; PRPA would not receive any economics from the airport beyond the upfront payment for the duration of the Lease (except applicable local taxes)
 - The PRPA, depending on the agreement, may retain certain functions tied to the airport such as police, emergency management services and fire and rescue services

The economics of such a transaction are examined in the Economic Feasibility and Affordability Analysis sections of this document.

4.12. Approval framework

There are two streams of approvals that are needed for a concession of Luis Munoz Marin International Airport: (1) the required FAA and airline approvals pursuant to the FAA's airport Pilot Program and (2) the approvals required by the PPP Act in Puerto Rico. The details of the FAA approval framework are below:

FAA and airline approvals

The Puerto Rico Ports Authority submitted its preliminary application to participate in the FAA's airport Pilot Program on December 1, 2009, and the FAA completed its review of the preliminary application on December 22, 2009. The Ports Authority, and specifically Luis Munoz Marin International Airport, is guaranteed one of the five slots in the FAA program. This threshold allows the Ports Authority select a private operator to manage the airport, negotiate an agreement with the private operator, and prepare a final application for submittal to the FAA for final approval. There is no timetable for the FAA to complete its review of the final application. After the FAA reviews and approves the final application and lease, it publishes a notice in the Federal Register for a 60-day public review and comment period. The FAA completes its review, prepares its Findings and Record of Decision (ROD), and addresses the public comments in the ROD. The FAA publishes its ROD and, if approved, observes the legal settlement and transfer of the airport from public owner and sponsor to the new private operator and sponsor. Chicago's Midway Airport is the only airport to receive final approval from the FAA, though the transaction failed to close for financing reasons.

In addition to the approval of the FAA, there are approvals needed from the air carriers. The Federal Aviation Authorization Act of 1996 authorizes the FAA to exempt the Port Authority from certain requirements that could otherwise make a concession unattractive. First, the Port Authority may receive an exemption to use the lease or sale proceeds for non-airport purposes. Generally, all proceeds from the lease or sale of airport land must be used for the capital or operating costs of the airport. This exemption requires the approval of 65% of the air carriers at the airport (measured by number of carriers and by landed weight). The Port Authority also can be exempted from an obligation to repay federal grants and return property acquired with federal assistance upon the lease or sale of the airport.

The exemption to use net proceeds for non-airport purposes comes with conditions (listed in Title 49 United States Code §47134). These include the private operator's ability to prove it will comply with the public operator's grant obligations, including the obligation to ensure continued access to the airport by the public on reasonable terms. The private operator also must provide assurance that it will operate the airport safely, continue maintenance and improvement of the airport, provide security, mitigate noise and environmental impacts, and abide by any collective bargaining agreements already in place at the airport. The public operator also must provide a plan for continued operation of the airport in case of bankruptcy or other defaults of the private operator.

PPP Act in Puerto Rico

On June 8, 2009, the Government of Puerto Rico signed into law Act No. 29, entitled the Public-Private Partnerships Act (Act). According to the Act, it is the public policy of the Government of Puerto Rico to promote the establishment of Public-Private Partnerships (PPPs) for projects that the Act defines as Priority Projects. The Act requires a thorough process in which every project is required to complete a Desirability and Convenience Study. Subsequently, a Partnership Committee is created to monitor or day-to-day procedures of a procurement process for each project. The Act mandated that a procurement regulation be approved by the Board of Directors of the Public-Private Partnerships Authority (PPP Authority), a Governmental entity created to implement the PPP policy of Puerto Rico. The Partnership Committee would qualify potential bidders and evaluation their proposals. Final selection and award of Concession

agreements are subject to the approval of the Board of Directors of the PPP Authority and PRPA and finally be approved by the Governor or his delegate.

5. Economic feasibility analysis

5.1. Introduction

This section presents the economic feasibility analysis for the Project. To perform this analysis, PRPA developed historical financials for LMM that consider the direct and indirect allocated costs to run the Airport.

The value of the Airport will be based on a bidder's own financial model and upside that it believes exists at the Airport. It will also be dependent on the pro forma Airport Use Agreement, capital structure and the subsequent airline charges generated at the Airport.

The PRPA currently receives minimal economics from the Airport. In 2009, LMM generated approximately \$13 million in net profit. While the PRPA would no longer realize any profit in a PPP, it would generate significant interest cost savings. Meanwhile, the Government of Puerto Rico will receive higher income related to sales tax and municipal and real estate taxes. Additionally, the PRPA would not be responsible for implementing the costs associated with capital investments or financial efficiency initiatives. The cost / benefit comparison is presented in this section.

The Puerto Rican economy will also benefit as the private operator drives additional passengers through the Airport. This would result in increased gross product, tax revenues and job creation. Through the economics of the long-term lease, the private operator will be incentivized to increase passenger traffic.

5.2. Expected cost to the PRPA to continue to run the airport

In FY2009, LMM generated approximately \$13 million in net profit for the PRPA. The current rates and charges model is set up to effectively match airline charges with the costs to operate the Airport and the investment projects. The surplus, or profit to the PRPA, is heavily reliant on adjustments in the rates and charges process that yield airline charges in excess of operating costs, as well as the commercial, non-aero revenues that are generated at the Airport.

The financial initiatives that were proposed in section 4 of this document will take significant additional investment to implement. As discussed in section 3, LMM ranks last in food and beverage and car parking revenues per enplanement, relative to its peers. It also ranks well below peers on car rental revenues per enplanement. The PRPA does not realize the full benefit of these auxiliary operations at the Airport today, nor do the operations provide optimal benefit to travelers. In order to improve LMM's standing relative to peers and generate additional upside for the PRPA, a significant investment would need to be made. A selection of these investments is below:

- Improved financial systems for LMM standalone to monitor and manage costs effectively
- Improvements to retail and car rental spaces to attract more vendors
- Significant improvements and modernization of the car park structure, including self-service payment kiosks, CCTV at the exits, security monitoring, etc.
- Initiatives to drive more traffic through the airport to increase the attractiveness to vendors of operating at the Airport
- Examine current space utilization to ensure that space and passenger flow is optimizing revenue yields
- A dedicated LMM financial and accounting staff

While it is difficult to quantify the exact magnitude to enact such operational improvements, we believe the costs would be significant and greatly exceed the current \$13 million net profit per year that the Airport generates for some time.

5.3. Expected capital projects

In addition to the costs associated with financial efficiency initiatives, the PRPA would bear the execution and financing costs of capital improvement projects (CIPs). The management of the Airport and the PRPA has developed the following CIP for the Airport based on current needs:

(\$ in 000s)

FYE June 30,	2010	2011	2012	2013	2014	Total
Reconstruction of Taxiway Sierra	\$803	\$6,009	\$24,041	\$18,031	–	\$48,884
Improvements to Runway 8-26	–	–	–	5,000	18,000	\$23,000
Extension to Taxiway Sierra	–	10,115	10,116	–	–	\$20,231
Cargo Access Road & Sanitary System	3,868	9,000	3,912	–	–	\$16,780
New Terminal A	8,382	–	–	–	–	\$8,382
Security Fence & Security Access Road	500	7,500	–	–	–	\$8,000
South GA Access Road & Utilities	3,991	3,991	–	–	–	\$7,982
Access Control and CCTV Replacement	6,421	–	–	–	–	\$6,421
Water Storage Tanks & Pump Station	–	4,765	1,333	–	–	\$6,098
Extension to Midfield Taxiway (Dual)	495	–	–	4,700	–	\$5,195
Kilo Apron Extension	–	1,272	2,547	1,273	–	\$5,092
Improvements to Terminal D	4,342	–	–	–	–	\$4,342
Misc. Repairs and Maintenance	3,290	2,800	320	320	–	\$6,730
Total	\$32,092	\$45,452	\$42,269	\$29,324	\$18,000	\$167,137

Source: PRPA

The total costs of \$167.1 million to execute the Airport's current CIP will be the responsibility of the PRPA. This is incremental to the costs of running the Airport, as well as the financial initiatives described above.

The financing of these projects would be dependent on the credit profile of the PRPA, given that LMM does not currently issue debt on its own. As the PRPA's financial profile and credit worthiness remain pressured, the financing cost of these projects becomes incrementally expensive.

5.4. Expected economic impact on the PRPA today of continuing to operate LMM as is

The financial impact of LMM on the PRPA today is summarized in three buckets:

- The net profit realized from the Airport through operations today;
- The cost to implement financial efficiency initiatives at the Airport; and
- The cost of the capital investments plus the cost of financing.

In order to illustrate the impact over the next five years (the time horizon of the current CIP), PRPA has made the following assumptions to show the present value impact:

- 10% discount factor with discounting back to July 1, 2009, the first day of the FY2010 year
- 3% growth in net profit at the Airport each year
- 8% cost of financing the CIP each year

The present value of the net profits is below:

(\$ in millions)

FYE June 30,	2009	2010	2011	2012	2013	2014
Net income	\$13	\$13	\$14	\$14	\$15	\$15
% growth	–	3.0%	3.0%	3.0%	3.0%	3.0%
Present value		\$12	\$11	\$11	\$10	\$9
Net present value	\$54					

The present value of the CIP and the financing cost is below:

(\$ in millions)

FYE June 30,	2010	2011	2012	2013	2014
Capital investment	\$32	\$45	\$42	\$29	\$18
Current year cost of financing	3	4	3	2	1
Previous years' cost of financing	–	3	6	10	12
Total financing cost	\$3	\$6	\$10	\$12	\$13
Total CIP cost	\$35	\$52	\$52	\$41	\$31
Present value	\$32	\$43	\$39	\$28	\$19
Net present value	\$161				

Note: Does not include PFC available for the financing of capital investments which at most will be approximately \$20 – \$25 million per year

When comparing the net present value of the net profits relative to the CIP it becomes clear that PRPA will experience a negative impact of \$107 million (\$54 million less \$161 million). In addition to these financial impacts, the cost to implement revenue and cost initiatives is likely to be significant.

5.5. Economic impact of pursuing a PPP

Under a PPP, the PRPA would receive an upfront payment, which could then be used to defease the current debt of LMM and other PRPA obligations and will free PRPA of future liabilities and expenses associated to LMM. This results in net proceeds today.

In addition, the PRPA bears no costs for maintaining the Airport under the PPP. In other words, the PRPA would not be responsible for the capital investments, nor the costs of implementing financial initiatives.

In addition, driving passengers through the Airport will ultimately benefit the broader Puerto Rican economy. According to an independent economic report prepared by Advantage Business Consulting, each tourist (which includes cruise ship passengers) to the Island in 2009 had an average impact on the Island's gross product of \$690 per passenger, including direct and indirect benefits. The report projects 5.6 million total visitors per by year by 2015. Increasing the total number of visitors by 400,000 would have a significant impact on the local economy:

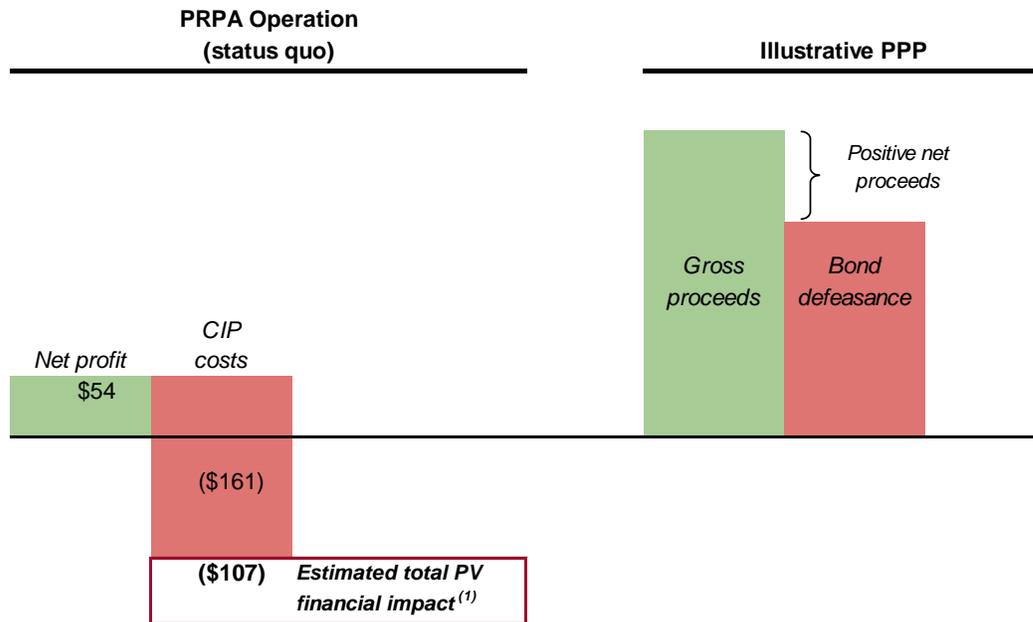
- Increase Puerto Rico's gross product by \$276 million
- Increase tax collections by \$34 million
- Create 3,772 new jobs

While the increase in visitors to the Island may come from a number of sources, LMM represents the major entry point for most tourists and provides the greatest opportunity to drive additional visitors.

5.6. Project impact summary

Taking into account the costs to the PRPA under the status quo and the proceeds to the PRPA under the PPP, the present value for money over the next five years is shown below:

(\$ in millions)



(1) Excludes the impact of the additional costs related to revenue and cost initiatives

The PRPA will not accept a bid with present value / upfront proceeds lower than the debt defeasance cost. Therefore, the NPV of the PPP will certainly be a positive number (and potentially a substantial dollar amount) and definitely better than the negative result of the PRPA operation.

This does not take into account the additional interest savings to the PRPA. The PRPA may choose to use the additional net proceeds to further reduce debt at the PRPA providing interest savings for the tenure of the debt. Additionally, the analysis does not place a quantitative value on the risk associated with the PRPA implementing these projects versus an experience airport operator. This analysis also does not take into account the direct and indirect benefits to the Puerto Rican economy from additional passenger flow through the Airport.

A summary of the value for money analysis is below:

	Status quo	PPP
PRPA Operating Cost	<ul style="list-style-type: none"> PRPA bears all costs for maintaining airport 	<ul style="list-style-type: none"> PRPA bears no costs for maintaining airport
Capital Improvement Projects (CIP)	<ul style="list-style-type: none"> PRPA responsible for \$167 million in CIP projects over next five years 	<ul style="list-style-type: none"> Concessionaire bears all responsibility
GDB Credit Profile Impact	<ul style="list-style-type: none"> CIP projects will be funded at GDB credit rating of Baa3 	<ul style="list-style-type: none"> All debt is defeased and eliminates all interest costs tied to Airport
Airport Operations	<ul style="list-style-type: none"> Day-to-day airport operations, a non-core competency, maintained by PRPA 	<ul style="list-style-type: none"> All operating risk transferred to private, world-class operator
Economic Output from Airport Today	<ul style="list-style-type: none"> Approx. \$13 million in net income from LMM in fiscal year 2009⁽¹⁾ 	<ul style="list-style-type: none"> Potential to realize substantial net proceeds today

A PPP enables the PRPA to realize a meaningful economic benefit from LMM today

(1) Source: Puerto Rico Ports Authority; assumes allocation of central office costs

6. Affordability analysis

6.1. Introduction

In addition to identifying the economic benefits of the Project, PRPA must also understand its affordability, as well as whether there are any financial implications that may affect the feasibility of implementing such a project. This section examines the affordability of the Project and other potential financial implications such as accounting, preparation of financial statements, and budget processes.

6.2. Description of proposed basic contract and payment structure

As presented in Section 4, PRPA advocates a PPP whereby a Concessionaire compensates PRPA through a one-time payment for the long-term lease of the airport. Principal elements of the lease include:

- 50 year duration (maximum term)
- Airport Use Agreement between the airlines and Concessionaire whereby the Concessionaire is obligated to operate the airport under certain operational guidelines and define a set compensation structure whereby the airlines compensate the Concessionaire for use of the airport
- Ability for PRPA to charge penalty fees or reassume control of the airport if the Concessionaire fails to meet certain operating and financial standards and obligations
- Concessionaire retains all future liabilities and economic benefits from the airport, however, the PRPA is not obligated to make any future payments pursuant to airport upgrades or day-to-day operational needs

The magnitude of the upfront payment will be determined through an extensive auction process whereby potential Concessionaires will base their bids on the perceived level of economic output that LMM could conceivably generate over the prolonged lease period, accounting for certain operational upgrades funded by the Concessionaire. After receipt of the upfront payment, PRPA will no longer be entitled to any compensation from the airport or the Concessionaire through any performance-based contracts or any other mechanism. The PRPA will bear neither liabilities nor new debt associated with LMM. PRPA can utilize the upfront proceeds to defease debt obligations pursuant to the airport and toward other infrastructure projects in Puerto Rico.

6.3. Affordability implications

PRPA has determined that for the Project to be affordable, the cost of the PPP today must not exceed the cost the PRPA would bear over the next 5 years to execute various airport upgrades. In addition, the upfront payment will have to exceed the present debt levels of PRPA in order for the project to be affordable.

Costs of PPP to the PRPA Today

PRPA would assume no material cost for the PPP today. The only costs assumed by the PRPA in accordance with the PPP would be payments to requisite advisors, legal counsel and consultant fees for their assistance in procuring a Concessionaire. PRPA would not be required to make any incremental capital investments in the airport or incur any additional costs to prepare the airport for a potential lease by a third-party concessionaire.

Costs of PRPA Performing Airport Upgrades on a Standalone Basis

PRPA is currently conducting additional analyses to evaluate the exact costs of potential upgrades. However, initial indications suggest that such upgrades would require significant upfront capital investment. In addition to the actual costs of the upgrades, PRPA would also bear the risks and costs of contractors to execute the projects as well as market risks and costs related to the financing of such projects. There may also be ongoing maintenance costs for these projects for an undeterminable period which the PRPA could incur. Additionally, note that any economic benefits earned through annual profits at LMM would be earned over a long period while costs to maximize such profits would need to be incurred immediately.

6.4. Accounting, financial statement and budget implications

PRPA is in the process of reviewing the implications the execution of PPP contracts may have on its accounting practices, on the preparation of its financial statements, and on its ability to meet the requirements and obligations of its agreement with certain creditors. Any resulting implications will be addressed by PRPA, and final determinations will be made upon receipt of proposals and negotiation of final PPP contract terms. However, PRPA does not expect any negative financial implications to be derived from the PPP contracts. The PPP contract agreement will be subject to acceptable accounting standards.

The execution of the PPP contracts would trigger a few internal changes in the way PRPA prepares its annual budget. PRPA must create a new cost category in its budget to include the estimated costs associated with the execution of the PPP contracts. Second, PRPA must reflect the exclusion of future airport-related revenues and costs as they will no longer be subject to either.

These changes in PRPA's budgetary process are internal and are not expected to have any significant implications on external stakeholders.

7. Conclusion

Currently, Luis Muñoz Marín International Airport does not adequately serve the needs of Puerto Rico's air travelers, nor does it provide a substantial financial benefit to the PRPA. Additionally, the current issues at the PRPA, including financial performance, credit profile, reliance on GDB credit lines, misalignment with the objectives of the airlines, and weak specialized airport managerial practices, limit LMM's ability to improve its operations. As such, PRPA has concluded that it needs to significantly change the way LMM is currently operated. To do this, PRPA must leverage private sector expertise through a PPP to improve the service delivery of the Airport. Through a benchmarking and service delivery analysis, the PRPA has determined that significant opportunities exist at the Airport today.

PRPA has determined that the Project should include:

- A clear identification and transfer of risks associated to the future capital and operating improvements of LMM between PRPA and the private consortium;
- Implementing a capital improvement plan to upgrade and improve Airport infrastructure;
- Identify and realize additional revenue sources at the Airport which will improve the financial profile of the Airport and improve the services and amenities to the users; and
- Identify and implement cost management initiatives that will improve the financial profile of the Airport, making it a more attractive partner for existing and new air carriers.

PRPA has elected to implement a PPP and rely on private sector expertise through a long-term lease of the Airport to a consortium that includes a concessionaire and an airport operator. A Concession and Lease Agreement between the concessionaire and the PRPA would shift almost all of the risk to the private sector.

Taking into account the project costs, the PRPA is able to realize upfront net proceeds from a PPP transaction within the scope and framework of the FAA Pilot Program versus the unfavorable financial impact of implementing the project on its own. The value for money is clear:

- Net proceeds in present value terms under a PPP exceed the net costs in present value terms under the status quo.

A successful PPP of LMM will deliver the following results:

- World-class concessionaire delivering best practices to the operation of the Airport, resulting in a more user friendly experience for Puerto Rico's residents and visitors alike that will in turn generate more customer satisfaction. This will include the use of modern technology and more efficient management practices
- Increased Airport traffic via a broader spectrum of airlines, offering greater travelling choices for the local population and increased flow of tourists into Puerto Rico
- Incremental employment opportunities for the people of Puerto Rico, driven by capital / construction projects, expanded retail, food and beverage vendors and increased aircraft traffic
- No degradation of environmental or noise impact on surrounding communities
- A substantial upfront payment by a lessee that will more than offset repayment of LMM debt
- Decreased financial and operational risk for the PRPA and the Government of Puerto Rico
- Prestige of being the first airport to carry out a concession under the FAA Pilot Program
- At the end of the lease, a world-class airport facility will be either returned to Puerto Rico or re-lease for another upfront payment

The Project provides an integrated solution for LMM that should enhance the value of the airport as an infrastructure asset and attract significant investment for the benefit of Puerto Rico.